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No. 82-1471

In The
Supreme Court of the United States
October Term, 1982

THE DEPARTMENT OF REVENUE OF THE STATE OF MONTANA,

Petitioner,

vs.

FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION OF MISSOULA AND HAVRE FEDERAL SAVINGS AND LOAN ASSOCIATION,

Respondents.

REPLY BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

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TABLE OF CONTENTS

Pages

I. The issue in this matter is the interpretation of Federal Statutes and the Montana Legislative Enactment does not render it moot. 2

II. This Court is not being asked to issue an advisory opinion. 6

III. The last argument raised by Respondents goes to the merits of this case and is more appropriate under the Rules of this Court to be addressed in briefing on the merits. 6

Conclusion 7

Appendix ..... App. 1

TABLE OF AUTHORITIES

CASES:

Brockington v. Rhodes, 396 U. S. 41 (1969) 5

Bullock v. Carter, 405 U. S. 134 (1972) 5

Hunter v. Erickson, 393 U. S. 385 (1969) 5

STATUTES:

12 U. S. C. § 1433 1

12 U. S. C. § 1725(e) 1

12 U. S. C. § 2055 1

12 U. S. C. § 2079 1

TABLE OF AUTHORITIES—Continued

Pages

12 U. S. C. § 2134 1

31 U. S. C. § 649 1

31 U. S. C. § 742 ..... 1, 6

31 U. S. C. § 3124 1

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REPLY BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

This Reply Brief is submitted to the Court pursuant to Supreme Court Rule 22.5 in answer to Respondents' Brief in Opposition to Petition for a Writ of Certiorari to the Supreme Court of Montana.

This case concerns the correctness of the interpretation given to the following federal statutes by the Montana Supreme Court: 31 U. S. C. §§ 742[1], 649; 12 U. S. C. §§ 1433, 1725(e), 2055, 2079, and 2134. All of these statutes pertain to federal obligations and each contains exemptions

[1]Now Recodified as 31 U. S. C. § 3124, *See*, Brief of Amici Curiae in Support of Petition for Certiorari, at pp. 4-5, fn. 1.

regarding state taxation as well as particular exceptions thereto.

Pursuant to this Court's request, Respondents filed a Brief in Opposition to Certiorari and raised the following arguments:

(1) Enactment of Montana Senate Bill No. 335 has rendered the Petition for Certiorari and issue contained therein moot.

(2) This Court has been requested to render an advisory opinion in this matter.

(3) The Montana Supreme Court correctly interpreted the federal statutes underlying the issue presented for review.

To the extent that these assertions are raised for the first time, Petitioner will now address them.

I.

The issue in this matter is the interpretation of Federal Statutes and the Montana Legislative Enactment does not render it moot.

The 1983 Montana Legislature enacted Senate Bill No. 335 in response to the Montana Supreme Court's decision in this matter.[2] See, Petitioner's Reply Appendix,

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[2]Respondents' Appendix contains a version of the Bill prior to enrollment and signature. Therefore Petitioner has included in this Reply Brief a signed copy of the Enrolled Bill.

App. 4-5. Since the Montana Legislature meets only once every two years, prophylactic action was needed to ensure preservation and continuity of the state's tax revenue base. However, as written, the new law does not affect the matter now before this Court either as to parties, subject matter, or issue for review. At this point of time, the new law, although currently effective, is not applicable to the present matter. The recent enactment applies only when federal law precludes state taxation of interest income. In the present matter this question, i. e., whether federal law prohibits inclusion of interest income in the measure of a nondiscriminatory franchise tax, has not been yet definitively answered. Consequently the matter and issue presented to this Court in both the Petition of the State of Montana and the Brief of the Amici Curiae is not moot.

The new statute provides a formula for proportionate disallowance of deductions attributable to interest income that is excludable from the measurement base of the Montana corporation license tax because of federal law. See, Petitioner's Reply Appendix, App. 6-7. The Respondents base their assertion of mootness on an erroneous reading of the new law. Respondents describe the new law in their Brief in Opposition to Certiorari at p. 7:

> Since the time of the decision by the Montana Supreme Court herein, the Montana legislature has changed the law such that *if interest income from these federal obligations is excluded in any fashion,* then the corporate taxpayer will lose deduction [sic] that it was previously entitled to for interest expense incurred in obtaining these tax-exempt federal obligations. Therefore, the issue as to whether the interest income from the specific federal obligations is subject to taxation under the Montana Corporation

> License Tax is moot because the taxpayer must either include the interest income or, if it is excluded, he must recalculate his interest expense deduction, on the basis of Senate Bill No. 335 and pay taxes on the disallowed interest expense. (Emphasis added.)

The Respondents assert that a corporation which excludes interest income for any reason must also reduce its deductions in conformance with the new formula. In short, Respondents indicate to this Court that such a taxpayer has a voluntary option to either, (1) include the interest income in the measurement and receive all of its deductions or (2) exclude interest income and decrease its deductions accordingly.

Contrary to Respondents' assertion, there exists no such option for the taxpayer per the express words of the new law. The emphasized language from Respondents' brief, supra, constitutes an incorrect paraphrasing of the new law. The key language of the new law is as follows:[3]

> Section 1. Reduction of deductions related to excluded income. (1) A corporation, taxable under Title 15, chapter 31, part 1, that excludes interest from gross income *which would be taxable except for federal law* must adjust its allowable deductions for all taxable periods for which interest is excluded in the following manner: . . . (Emphasis added.)

The operative words are those emphasized. As can be readily ascertained, the formula for reduction of deductions is applicable *only* in instances where interest income has been determined not to be includable in the income measure of the Montana Corporation License Tax.

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[3]See, Petitioner's Reply Brief, Appendix, App. 5.

The triggering mechanism for the new law to be operable in the present matter is for the Petitioner to receive an adverse decision from this Court. Only at that time would the new law be applicable. Conversely, if the position of the Petitioner is determined to be correct then the formula would never be applicable to the instant case. Respondents' allegations of mootness is substantively fallacious per the express words of the new legislative enactment.

The new legislation does not affect the situation presented to this Court for review. See, *Bullock v. Carter*, 405 U. S. 134 (1972), *Brockington v. Rhodes*, 396 U. S. 41 (1969), and *Hunter v. Erickson*, 393 U. S. 385 (1969).

The Court should recognize that the result of this case is also not moot. Although the Montana Legislature provided a statutory mechanism to minimize the overall effect of loss of tax revenue in the event the decision of the Montana Supreme Court is upheld by this Court[4] the formula does not operate so as to result in a complete wash.

Preliminary calculations demonstrate that the State would collect less tax revenue under the offset of deductions formula. Thus there are actual dollars at stake for both the taxpayers and the Petitioner. Since the tax effect is not the same, both parties will be significantly affected by this Court's ultimate decision of the issue presented.

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[4]See, preamble to S. B. 355, Petitioner's Reply Appendix, App. 4-5.

II.

This Court is not being asked to issue an advisory opinion.

Petitioner agrees with the Respondents' characterization of the Montana Corporation License Tax as stated in Respondents' Brief in Opposition to Certiorari, at p. 9:

> *Here, respondents and petitioner have no adverse or conflicting claim with regard to whether the Montana Corporation License Tax is a franchise tax.* Their only conflicting claim is whether the interest income from the specific federal obligations involved herein can be subject to tax under the Montana Corporation License Tax. (Emphasis added.)

Petitioner is not requesting this Court to definitively affirm the characterization of the tax, as that has already been done by the Montana Supreme Court, in its rightful province, *see*, Petition for Certiorari, pp. 11-12.

As framed in the Petition for Certiorari at p. i., the question presented for review concerns: (1) whether the Montana tax satisfies the exception contained in 31 U. S. C. § 742 and (2) whether the immunity described in certain federal statutes providing for issuance of certain federal obligations is broader than that provided by 31 U. S. C. § 742. Clearly, Petitioner is not asking for an advisory opinion.

III.

The last argument raised by Respondents goes to the merits of this case and is more appropriate under the Rules of this Court to be addressed in briefing on the merits.

CONCLUSION

As Petitioner has demonstrated, the issue presented to this Court for review is not moot. Because of the import of this viable question to the Petitioner and the 25 states appearing as *Amici*, the Court is urged to grant plenary consideration and resolve the issue.

Respectfully submitted,

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APPENDIX

CHAPTER NO. 673

SENATE BILL NO. 335

INTRODUCED BY TOWE, TURNAGE, FABREGA, YARDLEY, WILLIAMS, MARKS, RAMIREZ, ABRAMS, THOMAS, ASAY, BLAYLOCK, GOODOVER, McCALLUM, KOLSTAD, HARRINGTON, NEUMAN, ZABROCKI, DONALDSON, SEVERSON, CHRISTIAENS, KITSELMAN, NORDTVEDT

IN THE SENATE

February 1, 1983	Introduced and referred to Committee on Taxation.
February 2, 1983	Fiscal Note requested.
February 8, 1983	Fiscal Note returned.
February 23, 1983	Committee recommend bill do pass. Report adopted.
February 28, 1983	Bill printed and placed on members' desks.
March 1, 1983	Second reading, do pass.
March 2, 1983	Correctly engrossed.
March 3, 1983	Third reading, passed. Ayes, 48; Noes, O. Transmitted to House.

IN THE HOUSE

March 7, 1983	Introduced and referred to Committee on Taxation.
March 23, 1983	Committee recommend bill be concurred in as amended. Report adopted.
March 26, 1983	Second reading, concurred in as amended.
	Third reading, concurred in.

IN THE SENATE

March 29, 1983	Returned to Senate with amendments.
April 8, 1983	Second reading, amendments concurred in.
April 11, 1983	Third reading, amendments concurred in. Ayes, 50; Noes, 0.
	Sent to enrolling.
April 13, 1983	Correctly enrolled.
	Signed by President.
April 14, 1983	Signed by Speaker.
April 15, 1983	Delivered to Governor.
April 20, 1983	Returned from Governor with recommended amendments.
	Second reading, Governor's amendments not concurred in.

IN THE HOUSE

April 20, 1983	Governor's amendments transmitted to House.
April 21, 1983	On motion of April 20, 1983, Governor's amendments placed on second reading this day.
	Second reading, Governor's amendments concurred in.
	Third reading, Governor's amendments concurred in.

IN THE SENATE

April 21, 1983	On motion, Free Conference Committee requested and appointed.
	Free Conference Committee reported.

Second reading, Free Conference Committee report rejected. Ayes 26; Noes, 23.

Free Conference Committee dissolved.

On motion, new Free Conference Committee requested and appointed.

New Free Conference Committee dissolved.

On motion, second new Free Conference Committee requested and appointed.

Second new Free Conference Committee reported.

Second reading, second new Free Conference Committee report rejected. Ayes, 35; Noes, 15.

Second new Free Conference Committee report rejected by House.

IN THE SENATE

April 21, 1983 — Returned to Senate. Sent to enrolling.

Returned to Governor for further consideration.

AN ACT TO DISALLOW DEDUCTIONS RELATED TO EXCLUDED INTEREST INCOME FOR MONTANA CORPORATION LICENSE TAX PURPOSES; TO APPLY THE DISALLOWANCE OF DEDUCTION RETROACTIVELY TO ALL TAXABLE PERIODS DURING WHICH SUCH INCOME IS EXCLUDED FROM GROSS INCOME; PROHIBITING CONSOLIDATED RETURNS FOR FINANCIAL INSTITUTIONS UNDER THE CORPORATE LICENSE TAX; REAFFIRMING THE INCLUSION OF STATE AND LOCAL BOND INCOME IN

THE DEFINITION OF NET INCOME FOR CORPORATION LICENSE TAX PURPOSES; AND PROVIDING AN IMMEDIATE EFFECTIVE DATE AND APPLICABILITY DATES.

WHEREAS, the Montana Corporation License Tax Act (Title 15, chapter 31, part 1) was intended, after the enactment of Chapter 634, Laws of 1979, to require all corporations to report and pay a tax upon all income derived from obligations of the United States or its agencies or instrumentalities as permitted by Title 31, section 742, United States Code; and

WHEREAS, the Montana Supreme Court on September 23, 1982 (petition for rehearing denied December 6, 1982), decided in the case cited below that such income must be excluded from the measure of the subject tax; and

WHEREAS, the Legislature disagrees with the Montana Supreme Court's decision in the case of *First Federal Savings and Loan Association, a Federally Chartered Association, et al., Plaintiffs and Appellants v. Department of Revenue, et al., Defendants and Respondents,* Cause No. 81-528, and has filed, through its Revenue Oversight Committee, an *Amicus Curiae* brief in support of the position of the Department of Revenue; and

WHEREAS, the Department of Revenue is presently seeking to have the United States Supreme Court review the matter, and at this time other decisions are also being reviewed by the United States Supreme Court that might have a bearing on the issue of the taxability of such income; and

WHEREAS, in the interim uncertainty exists as to the taxability of such income and claims for refund of

tax and returns of income will be made by corporations based upon the exclusion of such income; and

WHEREAS, the Legislature desires to maintain approximately the current level of revenue to state and local government; and

WHEREAS, immediate legislative action is necessary.

THEREFORE, it is the intent of the Legislature to proportionately reduce the allowable deductions to all corporations for all taxable periods for which interest income is excluded or claim for refund of tax is made upon such exclusion under claim of right under federal law.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MONTANA:

Section 1. Reduction of deductions related to excluded income. (1) A corporation, taxable under Title 15, chapter 31, part 1, that excludes interest from gross income which would be taxable except for federal law must adjust its allowable deductions for all taxable periods for which interest is excluded in the following manner:

(a) the total amount of interest excluded from gross income by federal law must be determined;

(b) the total amount of all interest income from all sources must be determined;

(c) the ratio of excluded interest income to all interest income must be determined; and

(d) the total deductions allowable under 15-31-114 must be reduced by an amount determined by multiplying the amount of deduction otherwise allowable by the ratio

of excluded interest to all interest income; however, the product of this calculation may not exceed the amount of excluded interest income.

(2) Allowable deductions must be reduced with respect to all corporations that exclude interest income otherwise taxable upon returns filed for all taxable periods for which such exclusion is claimed and for all taxable periods for which a claim for refund is made.

Section 2. Consolidated returns prohibited. (1) A majority of the corporation license tax collected from financial institutions is paid to local government areas in which each financial institution is located. However, consolidated returns for financial institutions do not reflect the true tax attributable to each local government. In addition, consolidated returns would permit financial institutions to offset income deductions for all taxable periods for which interest is excluded in the following manner:

(a) the total amount of interest excluded from gross income by federal law must be determined;

(b) the total amount of all interest income from all sources must be determined;

(c) the ratio of excluded interest income to all interest income must be determined; and

(d) the total deductions allowable under 15-31-114 must be reduced by an amount determined by multiplying the amount of deduction otherwise allowable by the ratio of excluded interest to all interest income; however, the product of this calculation may not exceed the amount of excluded interest income.

(2) Allowable deductions must be reduced with respect to all corporations that exclude interest income otherwise taxable upon returns filed for all taxable periods for which such exclusion is claimed and for all taxable periods for which a claim for refund is made.

Section 2. Consolidated returns prohibited. (1) A majority of the corporation license tax collected from financial institutions is paid to local government areas in which each financial institution is located. However, consolidated returns for financial institutions do not reflect the true tax attributable to each local government. In addition, consolidated returns would permit financial institutions to offset income against losses of nonfinancial institutions, thereby distorting the true income of each financial organization.

(2) In accordance with subsection (1), financial institutions are prohibited from filing consolidated returns under 15-31-141.

Section 3. Reaffirmation of bond income inclusion in definition of net income for corporation license tax purposes. Notwithstanding the provisions of any other law, the income from bonds or other obligations issued by any state or political subdivision of a state are included in gross and net income for purposes of the corporation license tax. Further, such income has been included in gross and net income since the effective date of Chapter 634, Laws of 1979, which law repealed the exclusion of such income from the tax base of the corporation license tax.

Section 4. Codification instruction. Sections 1 through 3 are intended to be codified as integral parts of Title 15, chapter 31, part 1.

Section 5. Severability. If a part of this act is invalid, all valid parts that are severable from the invalid part remain in effect. If a part of this act is invalid in one or more of its applications, the part remains in effect in all valid applications that are severable from the invalid applications.

Section 6. Effective date—applicability dates. This act is effective on passage and approval. Sections 1 and 3 of this act apply retroactively, within the meaning of 1-2-109, to taxable periods beginning on and after December 31, 1978 (the effective date of Chapter 634, Laws of 1979), for which a corporation has excluded interest income based upon federal law or for which a corporation has included interest income and subsequently claims a refund of taxes paid based upon federal law. Section 2 of this act applies to taxable periods beginning after December 31, 1982.

I hereby certify that the within bill originated in the Senate.

/s/ John W. Larson
Secretary of the Senate

/s/ Stanley D. Stephens
President of the Senate
Signed this 28th day of April, 1983.

/s/ Daniel Kemmis
Speaker of the House
Signed this 28th day of April, 1983.

CHAPTER NO. 673

SENATE BILL NO. 335

INTRODUCED BY TOWE, TURNAGE, FABREGA, YARDLEY, WILLIAMS, MARKS, RAMIREZ, ABRAMS, THOMAS, ASAY, BLAYLOCK, GOODOVER, McCALLUM, KOLSTAD, HARRINGTON, NEUMAN, ZABROCKI, DONALDSON, SEVERSON, CHRISTIAENS, KITSELMAN, NORDTVEDT

AN ACT TO DISALLOW DEDUCTIONS RELATED TO EXCLUDED INTEREST INCOME FOR MONTANA CORPORATION LICENSE TAX PURPOSES; TO APPLY THE DISALLOWANCE OF DEDUCTION RETROACTIVELY TO ALL TAXABLE PERIODS DURING WHICH SUCH INCOME IS EXCLUDED FROM GROSS INCOME; PROHIBITING CONSOLIDATED RETURNS FOR FINANCIAL INSTITUTIONS UNDER THE CORPORATE LICENSE TAX; REAFFIRMING THE INCLUSION OF STATE AND LOCAL BOND INCOME IN THE DEFINITION OF NET INCOME FOR CORPORATION LICENSE TAX PURPOSES; AND PROVIDING AN IMMEDIATE EFFECTIVE DATE AND APPLICABILITY DATES.

This bill was received by the Governor this 29th day of April, 1983.

/s/Ted Schwinden
Governor

By /s/ Martha Wahlstrand
Approved 4/29/83
/s/Ted Schwinden
Governor

STATE OF MONTANA
Filed May 2, 1983
Jim Waltermire
Secretary of State

By /s/ Marian F. Campbell
Deputy